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April 13, 1993

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

Ms. Donna R. Searcy
Secretary
Federal Communications Commission
1919 M Street, N.W., Room 222
Washington, D.C. 20554

RE: In the Matter of Simplification of the Depreciation Prescription Process
CC Docket No. 92-296

Dear Ms. Searcy,

Attached are the original and five copies of the Reply Comments of United Telephone - Southeast, Inc. in the proceeding referenced above.

Sincerely,

A handwritten signature in cursive script, appearing to read "Richard W. Cameron for".

Jay C. Keithley
Vice President
Law and External Affairs

Attachments

JCK/mlm

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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

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In the Matter of)

Simplification of the)
Depreciation Prescription)
Process)

CC Docket No. 92-296

REPLY COMMENTS OF
UNITED TELEPHONE-SOUTHEAST, INC.

United Telephone-Southeast, Inc. ("UTS") hereby submits its reply comments to the comments of others to the Notice of Proposed Rulemaking¹ issued by the Federal Communications Commission ("Commission"). The Commission proposed four alternatives for simplification of the depreciation prescription process. The Commenting local exchange companies ("LECs") included the Regional Bell Operating companies ("RBOCs"), GTE Service Corporation, United States Telephone Association ("USTA"), Cincinnati Bell Telephone and UTS. Interexchange carriers were represented by MCI Telecommunications Corporation ("MCI") and American Telephone and Telegraph Company ("AT&T"). State regulators from nearly a score of states and The National Association of Regulatory Utility Commissioners ("NARUC") also commented.

Generally, the LECs supported the Price Cap Carrier Option presented by the Commission. The LECs also identified, not

1. Simplification of the Depreciation Prescription Process, Notice of Proposed Rulemaking, CC Docket No. 92-296, FCC 92-537, (released December 29, 1992) ("NPRM").

unanimously, but in significant numbers, the Basic Factors Range Option (with modification) as a second best alternative.

State regulatory authorities often opposed significant changes in depreciation prescription, generally felt that it was premature to adopt the Price Caps Option as proposed, and predominately agreed that the Basic Factors Range Option was a good alternative if the Commission was determined to do anything significant to streamline the depreciation prescription process. The Depreciation Rate Range Option and the Depreciation Schedule Option generally lacked support.

UTS will focus its reply upon the problems identified by others concerning the Price Cap Option. The Price Cap Option is the preferred choice of UTS among the proposed plans. Additional material will be presented supporting what UTS views as the second best alternative--the Basic Factors Range Option.

II. THE PRICE CAP CARRIER OPTION IS APPROPRIATE AND SHOULD BE ADOPTED

Two primary concerns with the price cap option surfaced in comments. Many state regulatory agencies noted that if LECs were given complete depreciation freedom they may manipulate the depreciation prescription process to control earnings and game the price cap sharing process. Further, they might not depreciate assets quickly enough and that would cause future

ratepayers to fund the depreciation on assets that have no remaining useful life.²

UTS recognized the potential that LECs could game the price caps sharing mechanism through erratic adjustments to depreciation rates. In its comments, UTS proposed a method to detect potential gaming and a method to remedy any gaming that occurs. The UTS proposal revolves around a historical showing of depreciation rates over a five year period. If, after addressing current depreciation reserve deficiencies, total depreciation rates are erratic, the Commission should require an additional showing why these questionable depreciation rates are reasonable. If the Commission is not convinced, it should not approve the proposed rates.³

UTS also addressed the incentive a carrier would have to systematically underdepreciate existing plant. UTS noted that "underdepreciation accompanied by little additional investment inflates the current rate base and makes the carrier competitively vulnerable in the future."⁴ Further, the requirements of GAAP accounting, to which LECs must comply because they generally have publicly traded stock and debt, protect against

2. See, e.g. North Dakota Public Service Commission, Wisconsin Public Service Commission, and Virginia Corporation Commission Staff.

3. UTS Comments at 6-7.

4. Id. at 7.

depreciation abuse. GAAP accounting requires matching depreciation expense accruals with the useful life of assets. If a LEC were to systematically underdepreciate its assets, it would both violate GAAP accounting and reduce its future competitiveness.

It is clear that LECs are experiencing increasing competitive pressure by CAPs, cable systems, and IXC's in the access transport business. The requirements of CC Docket No. 91-141, where expanded interconnection of competitors' access transport networks is mandatory, will facilitate even greater competition in this portion of the LEC market. Further, as Gen. Doc. No. 90-314 indicates, personal communications systems, which along with cellular systems will compete with LEC local exchange service, are expected to burst into blossom in the near future and are likely to provide full scale competition to even local exchange service. Thus, LECs are subject to competitive pressures that mandate timely depreciation or the LEC will become competitively vulnerable because of its massive underdepreciated plant.⁵

UTS asserts that the price caps option, with the refinement proposed by UTS, is the superior option. It provides the LEC with the ability to match its depreciation expense with the useful life of its investment and it protects customers from gaming

5. See, e.g. Wisconsin Public Service Commission, Tennessee Public Service Commission staff, Utah Division of Public Utilities, and Missouri Public Service Commission.

of the price caps sharing process by implementing a check on unexpected but potential abuses.

**III. THE BASIC FACTORS OPTION IS AN INCREMENTAL IMPROVEMENT
BUT STILL A SECOND BEST OPTION**

an analysis of the comments of the state regulators in-

explained in its Comments why application of the Basic Factors Option should include all accounts.⁷

Because technology and competition are shortening the useful life of current investments, use of the Basic Factors Option on minor accounts like "motor vehicles" provides little assistance in reforming a process where major investments include accounts such as copper cable and switching systems. Competition and technology have had little recent impact on motor vehicle life as it applies to telecommunications total investment but tremendous impact upon switching and transmission systems. However, some regulators would provide reform where it will have little impact, in the "minor accounts," while maintaining outmoded practices in the major accounts where reform is most important.

UTS proposed a method to set "benchmark lives" for major accounts and "life ranges" for minor accounts. These ranges would be reviewed on an annual basis by industry representatives, Commission staff, and state regulators and approved by the Commission. Thus, the process would be appropriately monitored and controlled by the Commission. For those LECs that propose to use depreciation rates outside one or two standard deviations of the industry benchmarks, specific approval of their rates, supported by a showing justifying the deviation from the Basic Factors Range, would be required.

7. See UTS Comments at 8-10.

UTS believes that at least this level of depreciation reform is needed if LECs are to match their depreciation expenses to the rapidly changing useful lives of the investments. It is clear that competition and technological change have significant impact upon these useful lives. Depreciation practices must become more future-oriented to recognize these increasing depreciation pressures.

IV. CONCLUSION

UTS urges the Commission to stay the course in depreciation prescription reform. The advent of price caps regulation in concert with the acceleration of technological change and competition requires a future-oriented depreciation mechanism. UTS believes that the Price Caps Option, with the UTS proposed changes, provides the best alternative. If, however, the Commission provides less reform than that in the price caps option, the Basic Factors Option -- with the "benchmark lives" -- should be adopted.

Respectfully submitted,

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April 13, 1993

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CERTIFICATE OF SERVICE

I, Melinda L. Mills, hereby certify that I have on this 13th day of April 1993, sent via hand delivery or U.S. First Class Mail, postage prepaid, a copy of the foregoing "Reply Comments of United Telephone - Southeast, Inc." in the Matter of Simplification of the Depreciation Prescription Process, CC Docket No. 92-296, filed this date with the Secretary, Federal Communications Commission, to the persons on the attached service list.



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